Commonwealth of Massachusetts
State Ethics Commission

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CONFLICT OF INTEREST OPINION
EC-FD-95-1

FACTS:

You are a state employee who has been designated to file a yearly Statement Of Financial Interests (SFI) pursuant to G.L. c. 268B, §5(c). General Laws c. 268B, §5(g) delineates the categories of financial information which public employees are required to report regarding property holdings, business associations, securities, investments, gifts, honoraria, reimbursements, and certain creditor information.

You are a beneficiary in three family trusts. In each trust, the trust res consists of securities. In each trust, the trustee has the sole discretion to manage the trust res. You have no ability to direct or control the trustee's actions or the trusts' investments. You state that you receive a listing of the trusts' holdings on a yearly basis, but you have no knowledge of the trust's holdings at any given time during the year, and you have no power to direct the trustee to buy or sell any particular security. In fact, you state that you have never spoken to the trustee about these trusts.

The first trust was established by a grandparent's will. Upon your mother's death, you and your siblings became beneficiaries of this trust. According to the trust documents, you are entitled to receive the income, measured by a proportional share of the principal of the trust, during your lifetime. You are only entitled to receive the income and will never receive the principal. Upon your death, the principal will be paid to your surviving issue.

The second trust was established by a parent's will. Under this trust, you and your siblings have a right to the trust income, but not to the principal. Upon the death of the last of your siblings, the principal of the trust will be distributed to all of your parent's grandchildren.

The third trust was established by your grandparents. As your mother's issue, you, with your siblings, are entitled to the trust income. At the death of an individual who is unknown to you, but who was selected as a random measuring life, you and your siblings will be entitled to the trust principal.

QUESTION:

Is a public employee, who is an income beneficiary of a family trust, who may or may not be entitled to the principal of the trust, and who has no control over the trust investments, required to report the securities held in the trust, pursuant to G.L. c. 268B, §5?

ANSWER:

Yes.

DISCUSSION:

The Legislature, in G.L. c. 268B, §5(g), specified certain categories of information which public employees are required to include in their yearly SFIs. Section 5(g)(2) requires disclosure of "the identity of all securities and other investments with a fair market value of greater than one thousand dollars which were beneficially owned, not otherwise reportable thereunder..." At issue is the meaning of "beneficially owned".[1/] The term "beneficially owned" is not defined in G.L. c. 268B, and, as the Commission has noted in passing, is not a term

which has been commonly defined in the case law. *See EC-FD-87-2* (beneficial ownership not commonly used in law of trusts or used synonymously with term beneficial interest).

In determining the meaning which the Legislature intended to ascribe to the term "beneficially owned," we must analyze the nature of a trust beneficiary's interest in the trust res. Does one who has a right to income from a trust, but who may never receive any principal, have an ownership interest in the trust res§

The nature of a beneficiary's interest in the trust res has been a matter of dispute among legal theorists and among the courts. The United States Supreme Court has espoused a view, in several cases, that a trust beneficiary's interest is an ownership interest in the trust res. In *Brown v. Fletcher*, 235 U.S. 589 (1915) the Court was required to decide whether an interest in a trust assigned by a beneficiary was a property interest. The Court rejected the argument that the beneficiary's interest in the trust was a personal interest and right based upon the relationship between the trustee and the beneficiary, stating, "[t]he beneficiary here had an interest in and to the property that was more than a bare right and much more than a chose in action. For he had an admitted and recognized fixed right to the present enjoyment of the estate with a right to the corpus itself [at a future date]..." *Id*. at 599. The Court found that the assignment was not a chose in action payable to the assignee, but rather, was "evidence of the assignee's right, title, and estate in and to property." *Id.*

In *Blair v. Commissioner*, 300 U.S. 5 (1937) a question arose whether the life income beneficiary of a trust who had assigned his interests to his children was required to pay the tax on the income. Tax liability attached to ownership, and the Court was required to determine whether the beneficiary had assigned only a right to the income, and not any right, title or interest in the trust itself. *Id*. at 13. The Court, re-affirming *Brown*, concluded that:

The will creating the trust entitled the petitioner during his life to the net income of the property held in trust. He thus became the owner of an equitable interest in the corpus of the property.... The assignment of the beneficial interest is not the assignment of a chose in action but of the "right, title, and estate in and to property."

Id. at 13-14 (citations omitted); *see also Senior v. Braden*, 295 U.S. 422 (1935).

Professor Scott, a noted commentator in trust law, shares the view that a beneficiary holds a proprietary interest in the trust res, but he also recognizes that the question of whether the beneficiary has as proprietary interest in the subject matter of a trust is a difficult one. A. Scott, The Law Of Trusts §130 (3rd ed. 1967 & Supp. 1986). Professor Scott acknowledges that, in the early English law of uses, the use was considered a personal relationship between the trustee and the beneficiary. Scott argues that, as trust law has evolved, the nature of a beneficiary's interest has changed to include not only in personam rights, but also in rem rights. Scott contends that the fact that a beneficiary may be required to proceed through the trustee in actions against third parties does not mean that the beneficiary does not have a proprietary interest in the property, but only means that in protecting the beneficiary's interests, the trustee serves as the beneficiary's representative.

In comparison, Professor Powell, another noted commentator, in his treatise volume on trusts, opines that the preferable modern rule is that a beneficiary of a trust has only a chose in action plus other supplementary protection against interference by third parties. R. Powell, the Law Of Real Property §515 (1988 revision). He argues that, historically, a beneficiary's interest was personal, based on a right to compel the trustee to perform the established trust and rights against other parties who interfere with the trustee's performance of his obligations to the beneficiary. Powell would argue that a beneficiary's interest in a trust of securities is not an ownership interest in the securities, but is a chose of action to compel the trustee to administer the trust according to its terms. He does not believe that the evolution of the law justifies a change from the historical concept of a beneficiary's interest as one of rights against the trustee and that, considering the numerous types of trusts and beneficial interests today, it is not helpful to consider a beneficiary's interest to be an equitable ownership interest. He notes that numerous states[2/] have, by statute, vested all ownership, whether the interest is considered beneficial or legal, in the trustee.

Massachusetts has not joined other jurisdictions in enacting such a statute. We conclude that the courts in the Commonwealth would find that a beneficiary has a proprietary interest in the trust res. *See Ventura v. Ventura*, 407 Mass. 724, 726 (1990) (in express trust separation of legal and equitable control of property); *Baker v. Commissioner of Corporations and Taxation* 253 Mass. 130 (1925). The First Circuit

Court of Appeals has stated that

It must be conceded that in equity the beneficiary of a trust is the owner of the trust res; that he has an equitable estate in the property constituting the trust and is considered the real owner; that the trustee, on the other hand, holds the legal title to the property with the right to administer it for the benefit of the beneficiary and in accordance with the terms of the trust...

Welch v. Davidson, 102 F.2d 100, 102 (1939).

Similarly, in *Baker v. Comr. of Corporations and Taxation*, 253 Mass. 130 (1925), the Supreme Judicial Court was asked to decide the nature of a beneficiary's interest in order to determine whether the beneficiary was subject to an excise tax on real estate. The trust corpus contained a piece of real property. The beneficiaries were holders of certificates which entitled the beneficiaries to a right to the dividends from the property, but no rights to the property, or to call for partition or distribution. *Id.* at 132. The Supreme Judicial Court concluded that the interest of the certificate holders constituted an equitable interest in the land that was the trust res. *Id*. at 138.

In light of the legal decisions in this jurisdiction regarding the nature of a trust beneficiary's interest, we conclude that, for purposes of G.L. c. 268B, an income beneficiary of a trust has an ownership interest in the trust res. An income beneficiary receives a financial benefit garnered directly from the trust res. This benefit is an incident of ownership.

You suggest that we conclude that, for purposes of G.L. c. 268B, a beneficiary's ownership interest should constitute more than a right to income from the trust, but must also include a right to control or direct the trust res. We note that the term "beneficial ownership," as commonly used in securities law in relation to insider trading liability and to disclosure provisions, has been interpreted to include control over disposition of the security[3/] and a pecuniary interest in the security.[4/] *Mendell On Behalf of Viacom, Inc. v. Gollust*, 793 F. Supp. 474, 479 (S.D.N.Y. 1992). However, in judicial analysis, which aspect of ownership is considered most significant depends upon the purpose of the particular section of the securities law. *Id.*

We do not believe that the Legislature intended, and we are not inclined, to limit the investment disclosure requirement to those public employees who, as beneficiaries, are able to exercise substantial direction over the trust assets. The nature of the express trust relationship necessarily contemplates that a beneficiary will traditionally have limited control over the trust res, as legal title is vested in a trustee who receives such powers as are granted in the trust instrument. *See e.g., EC-FD-87-2.*

Further, from our review of the legislative history underlying G.L. c. 268B, we think that the Legislature, in using the term "beneficial ownership", intended to include not only those securities and investments directly held by a public employee, but also those investments held in trust for a public employee, who, in turn, receives benefits from those investments.

In the Initiative Petition filed in 1978, "the name and amount held, at fair market value, or (sic) stock, commodity options or mineral rights worth $1000 or more" was required to be reported. Early House drafts of the financial disclosure law retained this language. House No. 5715. An early Senate bill, Senate No. 1089, required the disclosure of trust income received and the "identity of all securities, investments (except for bank account balances) and real property (except for one's domicile) valued in excess of $1000, whether held directly or in trust for the reporting person's benefit."

In the following Senate bill, Senate No. 1540, this language was deleted and replaced by language patterned after the Initiative Petition. However, Senate No. 1540 was amended on the Senate floor to state:

the identity of all securities and investments with a fair market value exceeding one thousand dollars, whether held directly or in trust for the reporting person's benefit. The amount of each such holding shall be reported if:

(a) the reporting person is a public official or public employee of the commonwealth and the entity in which the investment or security is held is regulated by or does business with the commonwealth; or

(b) the reporting person is a public official or public employee of a county and the entity in which the investment or security is held is regulated by or does business with such county.

In addition, the amount of income exceeding one thousand dollars from each such holding shall be reported if paragraph (a) or (b) above is satisfied....

Thus, the legislative conference committee was faced with two proposed disclosure requirements for securities and investments. The House version did not specifically address securities or investments held in trust, whereas the Senate version did. The final bill, Senate No. 1626, contained the present language regarding beneficial ownership of securities. Although it may have been more precise to have retained the language "in trust for the reporting person's benefit," the Legislature may have chosen not to limit disclosure only to investments held directly or in trust, but may have also attempted to include other methods of investment holdings. At a minimum, the term "beneficial ownership" includes the trust relationship, as contemplated by the Senate versions of the law. Additionally, the Legislature is presumed to have knowledge of the judicial interpretations regarding a beneficiary's interest. *See e.g.*, *MacQuarrie v. Balch*, 362 Mass. 151, 152 (1972) (Legislature presumed to have knowledge of decisions of SJC).

Moreover, we are reluctant to apply a technical definition as used in securities regulation to the term "beneficial ownership." The Legislature, in G.L. c. 268B, §5(g)(2), did not limit the term to securities. "Beneficially owned" also modifies "other investments...not otherwise reportable thereunder".

Finally, our conclusion — that a trust beneficiary who is receiving income derived from the trust res is required to disclose the securities in the trust — furthers the purposes of G.L. c. 268B. Even if a public employee, who is a beneficiary, cannot control his investment, he may still be in a position to take official actions which would affect the stream of income he receives from the trust. The Financial Disclosure Law was enacted in order to assure the citizens of the Commonwealth of the "impartiality and honesty of public officials". *Opinion of the Justices*, 375 Mass. 795, 807 (1978). The requirement that certain policy-making public officials and public employees disclose personal investment information serves "to assure the people that 'the financial interests...present neither a conflict nor the appearance of a conflict with the public interest.'" *Id*. at 811.

DATE AUTHORIZED: July 11, 1995

[1/]The scope of this opinion does not address the issue of whether individuals who have future or contingent beneficial interests are required to report these interests on their SFIs. *See EC-FD-87-2*. Here, you have a present vested interest in the trusts. In *EC-FD-87-2*, without considering the meaning of "beneficially owned", we stated that one who has a present vested interest in a trust was required to report the trust, but one who had a contingent future interest would not be required to report the interest.

[2/]*See* e.g, New York Real Property Law §100; California Civil Code §863; Michigan Stat. Ann., §26.66.

[3/]The Securities and Exchange Commission has, by regulation, defined the term "beneficial ownership" in relation to its disclosure provisions requiring that certain investors notify the stock issuer and the Securities and Exchange Commission of an ownership interest of more than 5% of the issuer's stock. Under 17 CFR
§240.13d-3, ... a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares: (1) Voting power which includes the power to vote, or to direct the disposition of, such security; and/or,(2) Investment power which includes the power to dispose, or to direct the disposition of, such security.

The purpose of this disclosure requirement is to "alert investors in securities markets to potential changes in corporate control and to provide them with an opportunity to evaluate the effect of these potential changes." *Calvary Holdings, Inc. v. Chandler*, 948 F.2d 59, 62 (1st Cir.1991). Thus, the disclosure requirements target those individuals who are in a position to exercise the power to control or alter a corporation. *Id*. at 63.

[4/]The *Mendell* Court, in its review of the relevant precedent discussing beneficial ownership for purposes of insider trading liability, stated that "control without direct financial interest does not constitute beneficial ownership, and that even without complete or exclusive control direct financial interest in the issuers shares may itself constitute beneficial ownership." *Id*. at 480.